



Business Consulting Services

Financial Sector Annual Review and Strategy Forum

**Capital Markets: Building
Financial Sector Infrastructure**



Challenges Faced by Developing Markets

- Small markets, small size companies, low volumes of financial transactions
- Disincentives for public companies – high costs, no clear benefits
- Dominance of private transactions
- Low liquidity and few products
- High transaction costs
- Lack of regulatory transparency and enforcement
- Low information efficiency--weak disclosure and little dissemination
- Weakness of institutional investors to push corporate governance
- Low public (retail) participation level
- Capital flight
- Sustainability of stock exchanges and brokers uncertain

Scope of USAID Assistance in Capital Markets -- SEGIR FS/Transition Economies

- **Legal reform**
 - Develop securities market legislation
- **Regulatory capacity**
 - Develop regulations
 - Build institutional capacity, training
- **Trading platforms and clearance and settlement systems**
 - Establish Stock Exchanges (incl. technological infrastructure)
 - Establish C&S Infrastructure
- **Self Regulatory Organizations**
 - Assistance to SRO formation and capacity building

Results - SEGIR FS Projects in Armenia and Macedonia

- **Legal reform**
 - Lengthy, political, unpredictable timing and results – nevertheless successes in both countries
- **Regulatory capacity**
 - Quality of regulator depends on leader, political landscape
 - Enforcement an issue
- **Trading platforms and clearance and settlement systems**
 - Assistance in the establishment of the Stock Exchange in Armenia
 - Smart investment in technology – leverage USAID owned systems
 - Support for regional integration efforts in Macedonia
- **Self Regulatory Organizations**
 - Mixed record

Scope of USAID Assistance – Outside SEGIR FS

- **Philippines – USAID AGILE project**
 - Assistance to the regulator – enforcement, training
 - SRO – Assist in the establishment of a new Fixed Income Exchange

- **India – USAID FIRE project**
 - Assistance to the regulator – surveillance, restructuring and training, STP and T+1 issues
 - Establishing securities market law programs at institutions of higher education

Lessons Learned – USAID Capital Markets Projects

- **Legal reform**
 - Imperative
 - Coordinate with WB, IMF to help focus the government
- **Regulatory capacity**
 - Need to leverage local champions
 - Capacity building is a continuous “work in progress”
- **Trading platforms and clearance and settlement systems**
 - USAID investments in technology were a result of mass privatization - further investments improbable except for “early stages” markets
 - Further advisory needed to avoid systemic risks
- **Self Regulatory Organizations**
 - Progress very slow in “early stages” markets – donor patience required
 - Extensive support warranted when counterpart commitment in place

Global Trends and How They Affect Developing Markets

- **Liberalization of cross border investment flows**
 - Regulatory challenge, competition for capital and for customers, higher standards, capital outflows
- **Consolidation of financial services firms**
 - Regulatory challenge, competitive challenge for domestic financial intermediaries, higher standards
- **Expansion of financial instruments (securitization, derivatives)**
 - Regulatory challenge, risk management issues
- **Harmonization of disclosure (GAAP, IAS requirements)**
 - Regulatory challenge, pressure to implement higher standards
- **Active corporate governance**
 - Regulatory challenge, pressure to implement higher standards, to change regulations and practices

Financial Market Reform Going Forward: Approach

- **Build regulatory framework**
 - **Build/strengthen Regulators**
 - **Assist in the establishment of effective SROs**
- **Help develop industry skills (“early stages” markets)**
- **Implement international standards and best practices**
- **Coordination with WB/ADB/IADB for policy/conditionalities and with IFC and EBRD for direct financing of capital for private sector initiatives**

Financial Market Reform Going Forward: Interventions/Projects

- **Integrated Interventions/Projects – to include:**
 - **Strengthening the Regulators’ capabilities**
 - **Assistance to Intermediaries**
 - **To increase level of professionalism – “early stages” markets: Armenian NBF Incubator**
 - **To develop effective SROs (training, certification, international standards)**
 - **Implement pension and insurance reform**
 - **Help build regulatory framework and regulators**
 - **Help develop industry skills – “early stages” markets**
 - **Corporate governance**
 - **Drive reform of business environment: transparency, anticorruption, anti-money laundering**

- **Project mix dictated by:**
 - **Country level of development and political situation**
 - **Existence and jurisdiction of local champions**

Conclusions

- Main focus of financial sector interventions should be the development of a proper regulatory framework
- Integrated projects should be designed with optimal mix of components dictated by the country specifics